



6351-01-P

## **COMMODITY FUTURES TRADING COMMISSION**

### **17 CFR Part 23**

### **RIN 3038-AE77**

## **Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants**

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** The Commodity Futures Trading Commission (“Commission” or “CFTC”) is seeking comment on proposed amendments to the margin requirements for uncleared swaps for swap dealers (“SD”) and major swap participants (“MSP”) for which there is no prudential regulator. The proposed amendments would add the European Stability Mechanism (“ESM”) to the list of entities that are expressly excluded from the definition of financial end user and correct an erroneous cross-reference in the Commission’s regulations.

**DATES:** Comments must be received on or before **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

**ADDRESSES:** You may submit comments, identified by RIN 3038-AE77, by any of the following methods:

- CFTC Comments Portal: <https://comments.cftc.gov>. Select the “Submit Comments” link for this rulemaking and follow the instructions on the Public Comment Form.

- Mail: Send to Christopher Kirkpatrick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Center, 1155 21st Street, NW, Washington, DC 20581.

- Hand Delivery/Courier: Follow the same instructions as for Mail, above.

Please submit your comments using only one of these methods. Submissions through the CFTC Comments Portal are encouraged.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to <https://comments.cftc.gov>. You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that you believe is exempt from disclosure under the Freedom of Information Act (“FOIA”), a petition for confidential treatment of the exempt information may be submitted according to the procedures established in § 145.9 of the Commission’s regulations.<sup>1</sup>

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from <https://comments.cftc.gov> that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the rulemaking will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the FOIA.

**FOR FURTHER INFORMATION CONTACT:** Joshua B. Sterling, Director, 202-418-6056, [jsterling@cftc.gov](mailto:jsterling@cftc.gov); Thomas J. Smith, Deputy Director, 202-418-5495,

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<sup>1</sup> 17 CFR 145.9. Commission regulations referred to herein are found at 17 CFR chapter I.

*tsmith@cftc.gov*; Warren Gorlick, Associate Director, 202-418-5195, *wgorlick@cftc.gov*; Carmen Moncada-Terry, Special Counsel, 202-418-5795, *cmoncada-terry@cftc.gov*; or Rafael Martinez, Senior Financial Risk Analyst, 202-418-5462, *rmartinez@cftc.gov*, Division of Swap Dealer and Intermediary Oversight, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581.

## **SUPPLEMENTARY INFORMATION:**

### **I. Background**

In January 2016, the Commission adopted §§ 23.150 through 23.161 (collectively, “CFTC Margin Rule”) to implement section 4s(e) of the Commodity Exchange Act (“CEA”),<sup>2</sup> which requires SDs and MSPs for which there is not a prudential regulator (“CSEs”) to meet minimum initial and variation margin requirements adopted by the Commission by rule or regulation.<sup>3</sup>

Consistent with the administration of swap regulation, the Commission’s Division of Swap Dealer and Intermediary Oversight (“DSIO”), on an ongoing basis, reviews rules subject to its oversight, no-action letters and other grants of relief. In conducting that exercise, DSIO identified a no-action letter, further discussed below, whose codification would provide greater certainty to the marketplace concerning the scope and application of the CFTC Margin Rule and allow for its effective implementation. DSIO also

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<sup>2</sup> See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 FR 636 (Jan. 6, 2016) (“Final Margin Rule”); Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants — Cross-Border Application of the Margin Requirements, 81 FR 34818 (May 31, 2016).

<sup>3</sup> See 7 U.S.C. 6s(e)(1)(B). SDs and MSPs for which there is a “Prudential Regulator” must meet the margin requirements for uncleared swaps established by the applicable “Prudential Regulator.” 7 U.S.C. 6s(e)(1)(A). See also 7 U.S.C. 1a(39) (defining the term “Prudential Regulator” to include the Board of Governors of the Federal Reserve System; the Office of the Comptroller of the Currency; the Federal Deposit Insurance Corporation; the Farm Credit Administration; and the Federal Housing Finance Agency, and specifying the entities for which these agencies act as Prudential Regulators). The Prudential Regulators published final margin requirements in November 2015. See Margin and Capital Requirements for Covered Swap Entities, 80 FR 74840 (Nov. 30, 2015).

identified a typographical error in Commission § 23.157 that without correction would cause confusion in the application of the CFTC Margin Rule.

#### **A. No-Action Letter**

In July 2017, the ESM submitted a letter to the Commission requesting that SDs be relieved from the CFTC Margin Rule when entering into swap transactions with the ESM. The ESM represented that it was similar to the multilateral development banks that are listed in Commission § 23.151 (including the International Bank for Reconstruction and Development, the Asian Development Bank, and the European Investment Bank), which are excluded from the definition of financial end user and whose swaps are exempt from the CFTC Margin Rule. DSIO granted no-action relief, stating that it would not recommend enforcement action if an SD subject to the CFTC Margin Rule did not comply with that rule solely in respect of uncleared swaps between the SD and the ESM.<sup>4</sup>

### **II. Proposed Regulations**

#### **A. Amendment of Commission § 23.151 – Definition of Financial End User**

The CFTC Margin Rule applies to swap transactions between CSEs and counterparties that are SDs, MSPs or financial end users. Commission § 23.151 defines the term “financial end user”<sup>5</sup> and expressly carves out from the definition sovereign entities, multilateral development banks, the Bank for International Settlements, entities exempt from the definition of financial entity pursuant to section 2(h)(7)(C)(iii) of the

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<sup>4</sup> See CFTC Letter No. 17-34, Commission §§ 23.150 through 23.159, and 23.161; No-Action Position with Respect to Uncleared Swaps with the European Stability Mechanism (July 24, 2017) (“CFTC Letter No. 17-34”), available at <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrllettergeneral/documents/letter/17-34.pdf>.

<sup>5</sup> See 17 CFR 23.151.

Act and implementing regulations, affiliates that qualify for the exemption from clearing pursuant to section 2(h)(7)(D) of the Act, and eligible treasury affiliates that the Commission exempts from the requirements of Commission §§ 23.150 through 23.161 by rule.<sup>6</sup> The Commission proposes to revise the definition of financial end user to further exclude the ESM.

The proposed amendment would codify CFTC Letter No. 17-34, which provides relief from the CFTC Margin Rule with respect to uncleared swaps between SDs and the ESM. In granting relief, DSIO stated that the ESM, like multilateral development banks excluded from the financial end user definition, had a lower risk profile, posing less counterparty risk to an SD and less systemic risk to the financial system. While not explicitly finding that the ESM was a multilateral development bank, DSIO recognized that its function and credit profile justified the relief.<sup>7</sup>

The Commission proposes to amend the definition of financial end user in Commission § 23.151 by adding the ESM to the list of entities that are expressly excluded from the definition. As described in CFTC Letter No. 17-34, the ESM is an intergovernmental financial institution that provides financial assistance for national or regional development to Euro area member states that are in or are threatened by severe financial distress, similar to entities listed as multilateral development banks in Commission § 23.151, which are excluded from the definition of financial end user. To accomplish its policy goals, the ESM utilizes several financial assistance instruments,

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<sup>6</sup> *See id.*

<sup>7</sup> The Commission notes that the Basel Committee on Banking Supervision ascribes to the ESM a 0% risk weight. The ESM has been included in the list of entities receiving a 0% risk weight in the document entitled “Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework – Comprehensive Version, June 2006.” *See* BIS, Risk Weight for the European Stability Mechanism (ESM) and European Financial Stability Facility (EFSF), [https://www.bis.org/publ/bcbs\\_n117.htm](https://www.bis.org/publ/bcbs_n117.htm).

including loans in various forms which can be used for multiple purposes and are offered only subject to bespoke specified conditions, including economic reforms. The ESM regularly enters the international capital markets to fund these loans. It enters into uncleared swaps with SDs to hedge the interest rate and currency risks it faces as a result of entering into and funding these loans and to hedge risks associated with its invested contributed capital.

The Commission notes that, contemporaneously with the issuance of this proposal, DSIO staff is issuing a revised no-action letter to phase out the relief provided under CFTC Letter No. 17-34, which would instead be provided under Commission § 23.151. To allow adequate time for submission and review of comments, and finalization of the proposed amendment to § 23.151, the revised no-action letter will provide relief until the earlier of: (i) April 14, 2020 at 11:59 pm (Eastern Time); or (ii) the effective date of final Commission action on this rule proposal.

Based on the foregoing, the Commission proposes to exclude the ESM from the definition of a financial end user, which provides clarity and certainty to CSEs that uncleared swaps entered into with the ESM are not subject to the CFTC Margin Rule. The Commission believes that this approach is appropriate as activities conducted by the ESM, like activities conducted by multilateral development banks that are excluded from the financial end user definition, generally have a different purpose in the financial system. These types of entities are established by governments and their financial activities are designed to further governmental purposes. As such, the ESM, like multilateral development banks, has a lower risk profile and poses less counterparty risk to an SD and less systemic risk to the financial system.

The Commission also believes that this proposed rule will encourage international comity and continued cooperation between the Commission and EU authorities. In this regard, the Commission notes that the European Stability Mechanism is exempt from the European Market Infrastructure Regulation or EMIR's margin rules for OTC derivatives contracts not cleared by a central counterparty.<sup>8</sup> The proposed rule acknowledges the unique interests of the EU authorities in the ESM by excluding the ESM from the CFTC's margin requirements for uncleared swaps. The principles of international comity counsel mutual respect for the important interests of foreign sovereigns.<sup>9</sup>

Accordingly, paragraph (2)(iii) of the definition of financial end user in Commission § 23.151 would be amended by replacing "The Bank for International Settlements" with "The Bank for International Settlements and the European Stability Mechanism."

Request for comment: The Commission requests comment regarding the proposed amendment to Commission § 23.151. The Commission specifically requests comment on the following question:

- Are there any other risk factors or issues pertaining to the ESM's business model that the Commission should consider in finalizing this rulemaking?

**B. Amendment of Commission § 23.157 – Correction of Cross-Reference**

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<sup>8</sup> See Regulation (EU) No 648/2012 of the European Parliament and the Council of the European Union of July 4, 2012.

<sup>9</sup> See Restatement (Third) of Foreign Relations Law of the United States sec. 403 (Am. Law Inst. 2018) (the Restatement). The Restatement provides that even where a country has a basis for jurisdiction, it should not prescribe law with respect to a person or activity in another country when the exercise of such jurisdiction is unreasonable. See Restatement section 403(1). Notably, the Restatement recognizes that, in the exercise of international comity, reciprocity is an appropriate consideration in determining whether to exercise jurisdiction extraterritorially.

Commission § 23.157 requires initial margin collected from or posted by a CSE to be held by one or more independent custodians. The CSE must enter into a custodial agreement with each custodian that holds the initial margin collateral. In particular, paragraph (c)(1) of Commission § 23.157 provides that the custodial agreement must prohibit the custodian from rehypothecating, repledging, reusing, or otherwise transferring the collateral except that cash collateral may be held in a general deposit account with the custodian if the funds in the account are used to purchase an asset described in Commission § 23.156(a)(1)(iv) through (xii).

Commission staff has determined that the cross-reference to “§ 23.156(a)(1)(iv) through (xii)” in paragraph (c)(1) is erroneous. First, the existing cross-reference incorrectly refers to non-existing paragraphs. Second, the existing cross-reference excludes treasury securities and U.S. Government agency securities, which are included in the list of eligible collateral set forth in Commission § 23.156(a)(1), and which the Commission intended to include as eligible assets into which cash collateral can be converted.<sup>10</sup> The correct cross-reference should be § 23.156(a)(1)(ii) through (x). The Commission is proposing an amendment to Commission § 23.157(c)(1) to remove the erroneous cross-reference to “§ 23.156(a)(1)(iv) through (xii)” and replace it with the corrected cross-reference “§ 23.156(a)(1)(ii) through (x).”

Request for comment: The Commission requests comment regarding the proposed amendment to Commission § 23.157.

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<sup>10</sup> In the Final Margin Rule, the Commission explained that its intent was to exclude “immediately available cash funds,” which is one form of eligible collateral in Commission § 23.156(a)(1), because allowing such eligible collateral to be held in the form of a deposit liability of the custodian bank would be incompatible with Commission § 23.157(c)’s prohibition against rehypothecation of collateral. *See* Final Margin Rule, 81 FR at 671. However, the Commission expressly stated that the custodian could use the cash funds to purchase other forms of eligible collateral. *See id.*

### **III. Administrative Compliance**

#### **A. *Regulatory Flexibility Act***

The Regulatory Flexibility Act (“RFA”) requires Federal agencies to consider whether the rules they propose will have a significant economic impact on a substantial number of small entities and, if so, provide a regulatory flexibility analysis respecting the impact.<sup>11</sup> Whenever an agency publishes a general notice of proposed rulemaking for any rule, pursuant to the notice-and-comment provisions of the Administrative Procedure Act,<sup>12</sup> a regulatory flexibility analysis or certification typically is required.<sup>13</sup> The Commission previously has established certain definitions of “small entities” to be used in evaluating the impact of its regulations on small entities in accordance with the RFA.<sup>14</sup> The proposed amendments only affect certain SDs and MSPs and their counterparties, which must be eligible contract participants (“ECPs”).<sup>15</sup> The Commission has previously established that SDs, MSPs and ECPs are not small entities for purposes of the RFA.<sup>16</sup>

Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the proposed alternatives will not have a significant economic impact on a substantial number of small entities.

#### **B. *Paperwork Reduction Act***

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<sup>11</sup> 5 U.S.C. 601 *et seq.*

<sup>12</sup> 5 U.S.C. 553. The Administrative Procedure Act is found at 5 U.S.C. 500 *et seq.*

<sup>13</sup> *See* 5 U.S.C. 601(2), 603, 604, and 605.

<sup>14</sup> *See* Registration of Swap Dealers and Major Swap Participants, 77 FR 2613 (Jan. 19, 2012); 47 FR 18618 (Apr. 30, 1982).

<sup>15</sup> Pursuant to section 2(e) of the CEA, 7 U.S.C. 2(e), each counterparty to an uncleared swap must be an ECP, as defined in section 1a(18) of the CEA, 7 U.S.C. 1a(18).

<sup>16</sup> *See* Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant,” 77 FR 30596, 30701 (May 23, 2012).

The Paperwork Reduction Act of 1995 (“PRA”)<sup>17</sup> imposes certain requirements on Federal agencies, including the Commission, in connection with their conducting or sponsoring any collection of information, as defined by the PRA. The Commission may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid Office of Management and Budget control number. The proposed rules contain no requirements subject to the PRA.

*C. Cost-Benefit Considerations*

Section 15(a) of the CEA requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA. Section 15(a) further specifies that the costs and benefits shall be evaluated in light of the following five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission considers the costs and benefits resulting from its discretionary determinations with respect to the section 15(a) considerations.

In addition, the Commission notes that the consideration of costs and benefits below is based on the understanding that the markets function internationally, with many transactions involving U.S. firms taking place across international boundaries; with some Commission registrants being organized outside of the United States; with leading industry members typically conducting operations both within and outside the United States; and with industry members commonly following substantially similar business practices wherever located. Where the Commission does not specifically refer to matters

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<sup>17</sup> 44 U.S.C. 3501 *et seq.*

of location, the below discussion of costs and benefits refers to the effects of the proposed rules on all activities subject to the proposal, whether by virtue of the activity's physical location in the United States or by virtue of the activities' connection with or effect on U.S. commerce under CEA section 2(i).<sup>18</sup>

*1. Baseline and Rule Summary*

The baseline for the Commission's consideration of the costs and benefits of this proposed rulemaking is the CFTC Margin Rule. The Commission recognizes that to the extent market participants have relied on CFTC Letter No. 17-34, the actual costs and benefits of the proposed amendment to Commission § 23.151, as realized in the market, may not be as significant. The proposed amendment would revise the definition of financial end user in Commission § 23.151 to exclude the ESM from the definition. The amendment would codify CFTC Letter No. 17-34 and confirm that swaps with the ESM as a counterparty are not subject to the CFTC Margin Rule. As a result, CSEs facing the ESM as counterparties would not be required to exchange margin with the ESM, resulting in the collection of lesser amounts of margin to mitigate the risk of uncleared swaps. Nevertheless, the Commission believes that the proposed amendment is reasonable because the ESM's activity in the swaps market, as of the date of this proposal, is so limited that any potential unmargined exposure is unlikely to result in substantial systemic risk.<sup>19</sup> In addition, the Commission notes that the ESM is an intergovernmental financial institution established by the EU, and its stated purpose of

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<sup>18</sup> See 7 U.S.C. 2(i).

<sup>19</sup> Recent review of data from the swap data repositories indicates that the ESM engages in limited swap trading activity.

supporting member states in financial distress serves to manage and reduce risk to the EU financial system.

The Commission is also proposing to amend Commission § 23.157(c)(1) to remove the erroneous cross-reference to “§ 23.156(a)(1)(iv) through (xii)” and to replace it with the corrected cross-reference “§ 23.156(a)(1)(ii) through (x).” The Commission believes that custodial banks will benefit from being able to convert cash posted as initial margin into treasury and U.S. Government agency securities as was originally intended by the Commission.

## *2. Section 15(a) Considerations*

### *a. Protection of Market Participants and Public*

The proposed amendment to Commission § 23.151 would formalize CFTC Letter No. 17-34 and would confirm that swaps with the ESM as a counterparty are not subject to the CFTC Margin Rule. As discussed above, given the limited activity of the ESM in the swaps markets, the Commission believes that the unmargined exposure resulting from swaps between CSEs and the ESM is unlikely to result in significant risk to the financial system. Inasmuch as margin is posted to protect counterparties against credit risk, the creditworthiness of the ESM is critical to this analysis. The ESM has maintained high capital levels and has ultimate backing from the European Union.<sup>20</sup> Consequently, at this time, the Commission is comfortable that the ESM does not pose substantial counterparty

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<sup>20</sup> CFTC Letter No. 17-34 states that “[w]ith respect to its credit risk, as part of its emergency procedure, the ESM’s member states have irrevocably agreed to contribute a total of approximately €624 billion in additional capital should the ESM face financial distress. Further, the ESM is subject to limits on its lending and borrowing, and the ESM’s property, funding, and assets in its member states are immune from search, requisition, confiscation, expropriation, or any other form of seizure, taking, or foreclosure. In addition, to the extent necessary to carry out its activities, all property, funding, and assets of the ESM are free from restrictions, regulations, controls, and moratoria of any nature. The combined application of these rules and limits is effective in keeping the ESM’s total liabilities well below its available capital.”

credit risk. Thus, the Commission preliminarily believes that there would be no material impact on market participants and the general public relative to the status quo baseline.

*b. Efficiency, Competitiveness, and Financial Integrity of Markets*

The Commission preliminarily believes that the efficiency, competitiveness, and financial integrity of markets would not be significantly impacted by removing the requirement to post and collect margin in swap transactions with the ESM. One of the main functions of the ESM is to provide emergency assistance to members states of the European Union.<sup>21</sup> Given the nature of its operations, the ESM would be motivated to choose sensible, creditworthy counterparties thereby containing the credit risk exposure that the ESM may incur in swaps transactions.

*c. Price Discovery*

The proposed amendment to Commission § 23.151, which codifies CFTC Letter No. 17-34, would relieve the ESM and its counterparties from the CFTC Margin Rule, as the ESM would no longer be classified as a financial end user. The codification of the no-action relief as a rule would formalize a no-action position held by DSIO, promoting transparency concerning the applicability of the CFTC Margin Rule. Because there would not be a legal requirement that margin be posted in swap transactions with the ESM, such transactions would likely be for prices that deviate from similar swap transactions with financial end users but be in line with swaps with non-financial entities. As a result, swaps entered into with the ESM could increase, which could enhance, or at least not harm, the price discovery process.

*d. Sound Risk Management*

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<sup>21</sup> See CFTC Letter No. 17-34.

The ESM is an intergovernmental financial institution established by the EU and its financial activities are designed to advance EU objectives. The ESM's purpose is to manage the potential for systemic risk by providing support to member states that are in distress. The exposures posed by the ESM are therefore relatively unique. Relief from the CFTC Margin Rule may result in CSEs being more inclined to enter into swaps with the ESM, benefiting from the overall diversification of their swap portfolios, which is consistent with sound risk management.

*e. Other Public Interest Considerations*

As discussed above, the Commission believes that the proposed amendment to Commission § 23.151 is also warranted based on the interests of comity and the Commission's continuing cross-border coordination with EU authorities, such as the 2016 EC-CFTC Agreement, which has fostered cooperation and mutual respect between the CFTC and EU authorities.

*3. Request for Comment*

The Commission invites comment on its preliminary consideration of the costs and benefits associated with the proposed changes to Commission §§ 23.151 and 23.157, especially with respect to the five factors the Commission is required to consider under CEA section 15(a). In addressing these areas and any other aspect of the Commission's preliminary cost-benefit considerations, the Commission encourages commenters to submit any data or other information they may have quantifying and/or qualifying the costs and benefits of the proposal. The Commission also specifically requests comment on the following questions:

- Has the Commission accurately identified the benefits of this proposal? Are there other benefits to the Commission, market participants, and/or the public that may result from the adoption of this proposal that the Commission should consider? Please provide specific examples and explanations of any such benefits.
- Has the Commission accurately identified the costs of this proposal? Are there additional costs to the Commission, market participants, and/or the public that may result from the adoption of this proposal that the Commission should consider? Please provide specific examples and explanations of any such costs.
- Does this proposal impact the section 15(a) factors in any way that is not described above? Please provide specific examples and explanations of any such impact.
- Whether, and the extent to which, any specific foreign requirement(s) may affect the costs and benefits of the proposal. If so, please identify the relevant foreign requirement(s) and any monetary or other quantitative estimates of the potential magnitude of those costs and benefits.

*D. Antitrust Considerations*

Section 15(b) of the CEA requires the Commission to take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the objectives of the CEA, in issuing any order or adopting any Commission rule or regulation. The Commission does not anticipate that the proposed changes discussed herein will result in anti-competitive behavior. The Commission requests comment regarding whether the proposed changes could be deemed anti-competitive.

**List of Subjects in 17 CFR Part 23**

Capital and margin requirements, Major swap participants, Swap dealers, Swaps.

For the reasons stated in the preamble, the Commodity Futures Trading

Commission proposes to amend 17 CFR part 23 as set forth below:

## **PART 23 – SWAP DEALERS AND MAJOR SWAP PARTICIPANTS**

1. The authority citation for part 23 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 6, 6a, 6b, 6b-1, 6c, 6p, 6r, 6s, 6t, 9, 9a, 12, 12a, 13b, 13c, 16a, 18, 19, 21.

Section 23.160 also issued under 7 U.S.C. 2(i); Sec. 721(b), Pub. L. 111-203, 124 Stat. 1641 (2010).

2. In § 23.151, revise paragraph (2)(iii) of the definition of “Financial end user”

to read as follows:

### **§ 23.151 Definitions applicable to margin requirements.**

\* \* \* \* \*

*Financial end user* \* \* \*

(2) \* \* \*

(iii) The Bank for International Settlements and the European Stability

Mechanism;

\* \* \* \* \*

3. In § 23.157, revise paragraph (c)(1) to read as follows:

### **§ 23.157 Custodial arrangements.**

\* \* \* \* \*

(c) \* \* \*

(1) Prohibits the custodian from rehypothecating, replying, reusing, or

otherwise transferring (through securities lending, securities borrowing, repurchase

agreement, reverse repurchase agreement or other means) the collateral held by the

custodian except that cash collateral may be held in a general deposit account with the custodian if the funds in the account are used to purchase an asset described in § 23.156(a)(1)(ii) through (x), such asset is held in compliance with this section, and such purchase takes place within a time period reasonably necessary to consummate such purchase after the cash collateral is posted as initial margin; and

\* \* \* \* \*

Issued in Washington, DC, on October 16, 2019, by the Commission.

Christopher Kirkpatrick,

*Secretary of the Commission.*

NOTE: The following appendices will not appear in the Code of Federal Regulations.

**Appendices to Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants – Commission Voting Summary and Commissioners’ Statements**

**Appendix 1 – Commission Voting Summary**

On this matter, Chairman Tarbert and Commissioners Behnam, Stump, and Berkovitz voted in the affirmative. Commissioner Quintenz voted in the negative.

**Appendix 2 – Dissenting Statement of Commissioner Brian D. Quintenz to the Proposed Exclusion for the European Stability Mechanism from the Commission’s Margin Requirements for Uncleared Swaps**

In March 2018, I articulated my approach to our current regulatory relationship with our European counterparts in light of their refusal to stand by or re-affirm their 2016 commitments in the CFTC’s and European Commission’s common approach to the

regulation of cross-border central counterparties (CCPs) (CFTC-EC CCP Agreement).<sup>1</sup> Specifically, the absence of the agreement's re-affirmation directly implied the agreement's abrogation by the European Market Infrastructure Regulation 2.2 (EMIR 2.2).<sup>2</sup> I therefore vowed that I would either object to or vote against any relief provided to or requested by European Union authorities until the agreement's clarity was restored. While the possibility still exists for a successful outcome to EMIR 2.2 that fully respects the CFTC's ultimate authority over US CCPs, still no assurance has been given to remove that doubt.

I therefore dissent from today's proposed rule to exempt the European Stability Mechanism from the Commission's margin requirements for uncleared swaps.

The ESM plays an important role within Europe - an intergovernmental organization of the EU's Eurozone member states that provides financial assistance to those countries. The rule the CFTC is proposing to issue today would codify CFTC staff no-action relief permitting the ESM, unlike other financial entities, to enter into uncleared swaps with Commission-registered swap dealers without complying with the CFTC's margin regulations.<sup>3</sup> In proposing this rule, the CFTC has directed precious staff resources to provide legal certainty to an EU agency so that it may access CFTC-

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<sup>1</sup> Keynote Address of Commissioner Brian Quintenz before FIA Annual Meeting, Boca Raton, Florida (March 14, 2018),

<https://www.cftc.gov/PressRoom/SpeechesTestimony/opaquintenz9>;  
and

Joint Statement from CFTC Chairman Timothy Massad and European Commissioner Jonathan Hill, CFTC and the European Commission: Common approach for transatlantic CCPs (Feb. 10, 2016),  
<https://www.cftc.gov/PressRoom/PressReleases/pr7342-16>.

<sup>2</sup> The proposed implementation of EMIR 2.2 by ESMA is available at,  
<https://www.esma.europa.eu/press-news/esma-news/esma-consults-tiering-comparable-compliance-and-fees-under-emir-22>.

<sup>3</sup> CFTC Letter 17-34 (July 24, 2017),  
<https://www.cftc.gov/LawRegulation/CFTCStaffLetters/index.htm>.

supervised swap dealers with significantly greater flexibility than numerous US firms. Yet, we are taking this step while, and as I stated at last month's Global Markets Advisory Committee meeting, the proposed implementation of EMIR 2.2 has actually increased the likelihood of the CCP Agreement's nullification.<sup>4</sup> It is entirely unclear if any of the five US CCPs currently authorized to access the EU<sup>5</sup> will ultimately be treated as domestic EU firms and forced to follow EU rules.

Subjecting a US CCP to the same level of EU regulation as an EU CCP would unilaterally render null and void an agreement originally based on regulatory deference and mutual respect between two authorities. Even subjecting them to a re-application process under new or different criteria could nullify the 2016 agreement. And yet that re-application process is precisely the current expectation.

The CFTC-EC CCP Agreement promoted cross-border markets and regulatory efficiency because the CFTC and the European Commission agreed on where and how to defer to each other's regulatory regimes. A rule like the one proposed today, or the relief provided by CFTC staff to Eurex Clearing last December (to which I similarly objected)<sup>6</sup> provides special accommodations to an EU institution by relying on the CFTC's trust in our EU counterparts. Such trust continues to be misplaced until the EU can provide assurance that the CFTC-EC CCP Agreement will be upheld.

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<sup>4</sup> Opening Statement of Commissioner Brian Quintenz before the CFTC Global Markets Advisory Committee Meeting (Sept. 24, 2019), <https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement092419>. See also a similar Opening Statement by Commissioner Quintenz before the June 12, 2019 meeting of the CFTC's Market Risk Advisory Committee, <https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement061219>.

<sup>5</sup> CME, ICE Clear Credit, ICE Clear US, Minneapolis Grain Exchange, and Nodal Clear.

<sup>6</sup> Statement of Commissioner Brian Quintenz on Staff No-Action Relief for Eurex Clearing AG (December 20, 2018), <https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement122018>.

**Appendix 3 – Supporting Statement of Commissioner Dan M. Berkovitz on the Proposed Rule Excluding the European Stability Mechanism from Definition of Financial End User**

I support the proposed regulation that would add the European Stability Mechanism (“ESM”) to the list of governmental entities excluded from the definition of financial end user in the Commission’s margin regulations. The Commission has recognized for many years that entities established by governments like the ESM should be exempted from some of our regulatory requirements for financial entities. These entities serve a governmental purpose that is not to speculate or profit from derivatives and therefor are less likely to engage in activities that would bring risk to the United States. The ESM, an intergovernmental entity designed to assist EU member states in financial distress, would likely reduce systemic risk in the European Union. If the 2008 financial crisis is any guide, reducing financial distress in one region of the world is likely to benefit the rest of the world, including the United States.

In addition, comity is an important consideration when regulating entities established by a foreign government for a governmental purpose. The proposal will facilitate international comity and should encourage further cooperation. Showing reciprocal, mutual respect for the important interests of other sovereigns is an important step to harmonizing regulation and facilitating global markets where appropriate.

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